

MINUTES
MICHIGAN STATE TRANSPORTATION COMMISSION WORKSHOP
May 31, 2007
Lansing, Michigan

Meeting noticed in accordance with Open Meetings Act, Public Act 267 of 1976.

Present: Ted Wahby, Chair
Linda Miller Atkinson, Vice Chair
Maureen Miller Brosnan, Commissioner
James R. Rosendall, Commissioner

Also Present: Jacqueline Shinn, Chief Deputy Director
Larry Tibbits, Chief Operations Officer
Frank E. Kelley, Commission Advisor
Marneta Griffin, Executive Assistant
Jerry Jones, Commission Auditor
John Friend, Bureau Director, Highway Delivery
John Polasek, Bureau Director, Highway Development
Myron Frierson, Bureau Director, Finance and Administration
Tim Hoeffner, Administrator, Intermodal Policy

Excused: Kirk Steudle, Director
James S. Scalici, Commissioner

A list of those people who attended the workshop is attached to the official minutes.

Chair Wahby called the workshop to order at 10:35 a.m. in the Bureau of Aeronautics Auditorium in Lansing, Michigan.

The Workshop topic was Material Indexing.

John Friend introduced Mr. Tom Fudaly, Engineering and Operations Manager, Federal Highway Administration (FHWA), to present the national perspective on the use of material indexing.

Mr. Fudaly's presentation focused on:

Price Adjustment Clauses

This is a tool that FHWA supports for using and controlling project costs when it's appropriate. Price Adjustment Clauses (PAC) were first used in response to OPEC oil embargo of 1973, then again when Iraq invaded Kuwait in 1990.

A price adjustment clause establishes a method to adjust contract unit prices on specific materials experiencing uncontrollable price volatility. A PAC may be invoked if the price trend is extremely volatile (uncontrollable shifts away from normal price trends), suppliers are unable to provide price quotes for the term of a contract, the price quote is based on date of delivery or spot market conditions, or shortages are expected.

The standard upon which price adjustments are to be made should be real, quantifiable, and identified in the contract specifications. The standard should represent a price, or base index, that is not susceptible to manipulation by contractors or suppliers. The index may be State developed or any of the published commonly available data (including but not limited to Consumer Price Index (CPI)). Price adjustment special provisions must be developed in cooperation with FHWA and subject to approval by FHWA. Retroactive price adjustments are not eligible for Federal funding. Nationwide PAC are used for steel, diesel fuel, asphalt cement (AC).

Which States Use Price Adjustment Clauses

Based on 2005-2006 information, there were about 12 states using PAC for steel, including Oregon, Nevada, Illinois, Indiana, Ohio, Kentucky, Virginia, and New York. Some of the states chose to offer retroactive adjustments for a limited time period.

Quite a few states were using PAC for fuel, including Oregon, Nevada, Idaho, Utah, Colorado, Montana, Wyoming, North and South Dakota, Nebraska, Kansas, Louisiana, Florida, New York, Mississippi, Alabama, Tennessee, Kentucky, Ohio, North and South Carolina, Pennsylvania, and others.

States using PAC for asphalt cement include mainly the western and eastern coastal states (and a few interior states); i.e., Washington State, Oregon, California, Nevada, Idaho, Utah, Wyoming, Kansas, Oklahoma, Louisiana, Ohio, Kentucky, Mississippi, Alabama, Georgia, West Virginia, Maine, Massachusetts, North Carolina, and others.

Pros and Cons of PAC

Benefits with material indexing include: reduces contractor's risk of bidding (speculative bids); with STA (State Transportation Agency) assuming inflation risk, project costs should be reduced; and, in theory, provides a more level playing field by reducing price inflation risk for all bidders.

Concerns with material indexing include: does base index represent actual cost (industry risk); is index fair and unbiased and not subject to manipulation (SHA (State Highway Agency) risk); administrative issues associated with payment, processing monthly payments, interpretations, access to indexed information?.

Summarizing

In order for the PAC to be invoked, it would have to be initiated by a request from MDOT. We need to determine what the problem is that we are trying to solve—why add the clauses. FHWA does support PAC when applicable and appropriate; i.e., fuel price adjustments if you have a large grading job that is going to last a year or longer (9 months or more than 1 construction season). For a traffic signal job it probably is not appropriate or needed. PAC must to be assessed on a project by project basis. You can't just make a standard specification that applies to all jobs; it has to be uniquely tailored to the job.

John Friend presented the administrative cost associated with material indexing.

The Department set out to answer three questions: 1) why did we historically use indexing; 2) why did we stop; and, 3) estimate the administrative cost to implement indexing on an item.

We looked at archived Commission records (there is no historical information out there to be found), and talked to retired MDOT executives (those comments we received from them have been provided). In the administrative cost we tried to estimate the physical cost to doing this in terms of having a specification in place, what does it take to work through that specification on a monthly basis and adjust our contracts.

What would have happened if we had asphalt cement indexing in place in 2006? A straight cost calculation would have totaled \$270,000 in administrative costs.

Chair Wahby asked for questions.

Commissioner Brosnan asked Mr. Friend to go through the administrative costs of \$270,000.

Mr. Friend explained that he looked at the number of projects where they had a significant amount of hot mix asphalt involved from MDOTs and the local agencies' perspective, to come up with 375 projects, 4 months/project, 3 hours/month, \$60.00/hour equals \$270,000 in administrative costs. The \$60.00/hour is wage plus benefits cost and does not include an overhead multiplier.

Commissioner Brosnan commented that while \$270,000 is clearly a significant amount of money, but when you consider how much asphalt is involved, this is a relatively small percentage of the total project cost.

Mr. Friend agreed. What surprised him was the dollar impact to the program that could take place by having that index significantly change like it did in 2006.

Commissioner Brosnan asked him to expand a little on what his conclusions were about indexing, based on the information presented.

Mr. Friend explained that they looked at how different states around the nation index—frankly, they are all about the same. They take the standardized index when you let that bid—that becomes your baseline. Your other baseline is when they construct the project. The dollar difference is what the index adjustment is based on. The big difference for us is that we pride ourselves on letting our program in the first 6 months of the fiscal year, and then building it the second 6 months of the fiscal year. When we did this in 2006, it was like the perfect storm (or perfect risk for a SHA), because as we let our projects the index was fairly low. When we started to build those projects May through November, the index was off the chart. This year the index is fairly stable but on a downward trend.

Commissioner Rosendall stated that he needs to absorb this information for a week or two.

Ms. Shinn suggested that more discussion could be had at the next meeting or individual questions could be forwarded to Mr. Friend.

Chair Wahby agreed that time is needed to absorb the information. In the mean time Commissioners could contact the Department and this could be reviewed at the next meeting.

Commissioner Rosendall asked if they could submit their questions to Mr. Kelley who would distribute them to appropriate areas within the Department.

Chair Wahby responded yes.

Commissioner Atkinson thanked Mr. Friend and Mr. Fudaly for putting this information together.

PUBLIC COMMENTS

Chair Wahby asked if any member of the audience wanted to address the Commission concerning the workshop topic or regular meeting; none were forthcoming.

Chair Wahby asked if any Commissioner had further questions, comments or requests regarding the workshop topic or regular meeting; none were forthcoming.

ADJOURNMENT

There being no further business to come before the Commission, the Chair Wahby declared the workshop adjourned at 11:00 a.m.

Frank E. Kelley
Commission Advisor